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SUBJECT: PLAYING WITH THE MARGINS: FEW SIGNS OF LIFE IN THE
GOH'S ECONOMIC POLICY

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

THE FIERCE LASSITUDE OF NOW

¶1. (C) Following their recent meeting to discuss the fall legislative agenda, there appears to be little stomach among the MSzP leadership for further reforms. Party VP Imre Szekeres confides that there is at least "full consensus" within the party about one thing: "reversing our present strategy."

¶2. (C) Although MSzP sources continue to emphasize their commitment to continue with the Convergence Program, the emerging party line is that further steps must not "jeopardize social services." This has seemingly left most of their attention focused on marginal and revenue-neutral steps which will "rationalize services" and "redirect funds."

¶3. (C) While Szekeres concludes the party is now compelled to ratchet back on reform) "as we hoped to do anyway") he believes there is still time to take action on selected initiatives which will "do good for the people (and look good in the media." With a good crop expected this year, Szekeres believes that exports will push growth above western European levels and help give the GoH "400 billion forint worth of elbow room" for targeted social spending.

BITING THE HAND THAT INVESTS

¶4. (C) But that may not be enough. As Oriens Consulting Group Director Krisztian Orban points out, Hungary's labor participation is the lowest in Europe thanks to a system that offers few incentives for workers and places heavy burdens on employers. With its generous pensions, rampant abuse of disability provisions, and early retirement as a rule rather than an exception, Hungary's current system is "unsustainable." As Orban points out, however, the MSzP may well choose to attract voters rather than solve problems."

¶5. (C) The MSzP's evident focus on social spending at the expense of the investment climate will please no one in the business community. But Minister Peter Kiss, head of the Prime Minister's Office, appeared largely unmoved by strong statements from the AmCham, pointing vaguely to positive signs and predicting a turn-around this fiscal year. Told that the business community sees "no time to waste" on transparency and fears that "taxpayers have become Hungary's most endangered species," Kiss agreed to continue consultations with the AmCham but referred repeatedly to the importance of "social priorities" guiding the GoH's approach. He was encouraging regarding the elimination of the hated four percent "Solidarity Tax" on businesses but notably light on details regarding the fundamental reform he conceded is necessary. As one AmCham official concluded after a frustrating session, Kiss "knew enough to preempt our

questions but not to solve our problems."

THE SOCIALISTS' CARDINAL RULES

¶6. (C) At this point, we discern few ambitious plans on the MSzP's part. The broad outlines of their approach appear to be:

Continuing the Convergence Plan: Although this will help reduce the deficit, the Plan is a necessary but not a sufficient step toward long-term economic prosperity. As the investment community has warned, the pattern of enhancing revenues rather than reducing spending will continue to stifle growth.

Maintaining a revenue neutral approach: Kiss and others have been clear that the government will have to operate in a revenue-neutral environment. As Gyula Cserei, newly-appointed as head of the MSzP's foreign policy cabinet, observed, "there are things a Socialist government cannot propose." This means that the high level of social services and social subsidies will continue to dictate high tax rates. This constraint will undermine the impact of positive steps such as the prospective removal of the Solidarity Tax by imposing new costs such as higher VAT levels.

"Targeted Intervention" on employment generation: Although Minister Szucs emphasizes that her goal is to make work "voluntary and not obligatory," her "Way to Work" initiative will confront entrenched opposition. Its objective is to "rehabilitate" many of Hungary's 1.3 million long-term unemployed through professional training for workers,

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incentives for employers, and public works opportunities in hard-hit localities. This focus on communities beset by long-term unemployment may help the MSzP court important voters, but the program will likely fall far short of a dramatic transition from welfare to workfare.

Framing the debate: "Improved communication" remains part of the MSzP's mantra, and their latest approach is to frame their policy as the successor to the "Bokros Package" from the mid-90s. Although these austerity measures did help turn the economy around, the party's slow-down conveniently ignores Bokros' present advice, which is to accelerate reforms on all fronts.

LOSING THE POLITICS AND THE POLICY

¶7. (C) Comment: The marginal approach under consideration will not be enough for an economy which is rapidly losing the confidence of the very foreign investors on whom Hungary relies to keep its export-driven economy afloat. With few bold ideas seemingly on the horizon, it increasingly appears as if the MSzP is losing both the political race and the policy debate. In their recent meetings, both Kiss and Szekeres have demonstrated why they are Prime Ministerial aspirants and not Prime Minister. Often maddeningly vague, Kiss in particular prompted one AmCham official to comment "I was afraid that we weren't talking to the MSzP leadership (and now I'm more afraid that we are)." If these two long-time insiders are so far removed from the economic realities, we can have little confidence in the party's willingness to move beyond marginal changes. Worse still, indications are that any such changes will be in favor of voters rather than investors.
Foley